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Economic Conditions
Governmental Finance
United States Securities

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General Business Conditions

THE developments in the business situation during the past month have been unsettling in some respects, since they include weakness in the stock market in this country, a major financial crisis in France, and continued strain in European political affairs. According to precedent, the decline in stock prices may have some effect upon sentiment, and possibly upon trade; for those who believe that market movements tend to forecast business will wonder whether the optimists are overlooking any unfavorable factors. There are differing opinions as to how the French situation might affect American business, and it is uncertain to what extent the tax legislation or other political developments will disturb sentiment and discourage enterprise.

But except for these uncertainties there is evidently no occasion for revising hopeful views as to the Spring and Summer prospect. Business reports themselves have been decidedly impressive. Business is usually expected to improve at the beginning of Spring, due to the opening up of outdoor work, construction and other activities, but the rise has been greater than anticipated. Losses in production and sales caused by the bad weather in February and the floods in March have been more than regained. The margin of improvement in industrial operations, as compared with a year ago, has risen from 7 per cent in the first quarter to 12 or 15 per cent in April, and the total volume of production has reached the highest level since the Spring of 1930.

Moreover, trade has kept pace and the goods produced have been moving in an orderly way into consumers' hands. Automobile sales, always an important element in the Spring business, have exceeded expectations. Mr. Alfred P. Sloan, Jr., President of General Motors, states that the Corporation's retail sales during April have probably been higher than in any other month in its history, and its figures for March missed that distinction by only a few thousand units. The industry as a whole has been operating at a rate seldom reached even in pre-depression years, and the parts and accessory manufacturers, the tire companies, and gasoline business have been active correspondingly.

Steel mill operations, supported not only by automobile orders but by increased demand from a variety of industries, have risen rapidly since the interruption caused by the floods. The current rate is above 70 per cent of capacity for the first time since June, 1930. Many mills making light steel for automobiles, refrigerators, farm implements and similar goods, are operating at 100 per cent, and tin plate output is close to that figure. Structural and other heavy steels are the laggards.

Easter trade was generally satisfactory. It is difficult to give figures, for the April sales comparisons with 1935 are distorted by the differing dates of Easter, but unquestionably retail business has shown a good increase, and stocks of seasonal merchandise were cleared satisfactorily. Department stores have reported the highest dollar sales since 1931, and of course prices are lower, by an estimated 10 per cent, than in 1931.

First Quarter Earnings Increase

In addition to these and other evidences of trade improvement, interest has been centered during the month on the first-quarter earnings reports. In a few instances these proved disappointing, as in the building materials, auto accessories and coal mining groups. Nevertheless, the compilation published on a later page of this Letter shows that the total net profits, less deficits, of 245 manufacturing and trading corporations, were 42.3 per cent larger than in the same quarter last year, raising our index to 75 per cent of the 1926 average (preliminary estimate), compared with 53 a year ago. The improvement exceeds expectations, and is a credit to management, considering that high wages and taxes must be met

out of a still-depressed volume of business. These of course are outstanding companies, and the figures do not imply that all have done as well.

Moreover, the views of corporation chairmen, as expressed in the reports recently issued, are optimistic, based upon the expanding demand that they are experiencing in their own industries.

Reasons for the Improvement

It is true that the April gains were abnormally enlarged by business carried over from March, due to the floods; and after April the seasonal trend is downward. However, the basic reasons for the improvement, both natural and artificial, are persisting. Due to better balance in prices and other economic relationships, greater efficiency in production, lightening of debt burdens, and all the other adjustments which have been painfully accomplished, the exchange of goods is more practicable, individuals are able to satisfy a wider range of wants, and the industries are earning more and spending more. Buying power goes around the circle, and the improvement is cumulative. Likewise the Government's deficit expenditures, the artificial factor, are enlarging. During the Summer, with payments to the veterans and the farmers falling together, the purchasing power distributed to individuals by the Treasury will evidently be larger than in any comparable period. This, to be sure, is far from favorable in the long run, considering the debt and tax burden to be borne, but the temporary trade stimulus is undeniable.

An important factor in the business gains is the rise of farm buying power over a year ago, and the figures of farm income are encouraging because they indicate that the improvement is in considerable measure independent of subsidy. According to the Department of Agriculture, farmers' cash income in March was $528,000,000, including $15,000,000 in benefit payments, compared with $479,000,000, including $50,000,000 benefit payments, in March last year. During April benefit payments increased sharply, and they will be heavy for weeks to come, in discharge of the old A.A.A. contracts. But even without them farm income evidently would show increases. Cash income from marketings alone, in the first quarter of the year, was 20 per cent larger than a year earlier.

This is a striking gain, in view of the fact that prices of farm products, on the average, were slightly lower than in the first quarter last year. The increase in income was due entirely to larger production and consumption. It is plain that the volume of farm products sold was more than 20 per cent greater.

Production and Prices Better Balanced

Unquestionably these are significant figures. They show that abundant production can yield a greater income than scarcity, and of course the lesson applies to all producers. The demonstration is important in view of the larger acreages being planted to crops this year, and the possible larger production.

But the chief lesson from the facts shown is that the benefits of enlarged production have been mutual. The cities and the farms have improved together. The farmer has had more money, and consumers have had more farm products at lower prices. The standard of living has been raised by the increase in consumption, and the volume of goods passing in trade, upon which employment depends, has been increased.

It is also a source of encouragement that the cost of living has risen so little from last Summer to the present, a period of substantial business improvement. As compared with last July, retail food prices are 2.8 per cent lower, general merchandise prices (department stores) only 2.8 per cent higher, according to the Fairchild index, and the total cost of living, as calculated by the National Industrial Conference Board, only 1.8 per cent higher. The increase in national income during that period has not been due to rising prices, but to a greater volume of production, consumption, and trade, by which employment has been increased, and everyone enriched.

This is of practical significance in the business outlook. If prices had been rising rapidly over the period inventories would be accumulated, a check to consumption would inevitably occur, and business recession, as for example in the Fall of 1933, would be in order. Plainly the present situation is sounder. Production, payrolls and distribution for a year have risen together.

Not only is the price level more stable, but prices are in better relationship. The finished goods group of the Bureau of Labor Statistics price indexes (1926 = 100) is only 4 per cent above the raw products group, while at the low point of the depression it was 36 per cent higher. The highest commodity group, hides and leather, is only 39 per cent above the lowest, the "miscellaneous" group; whereas in February, 1933, the highest, metals and metal products, was 90 per cent over the lowest, farm products. These figures demonstrate nothing except the situation relative to 1926, for true parities among prices may shift constantly and cannot be measured in terms of past relationships. However, the figures show that prices have come closer together, and that the terms of exchange between the products of various groups of the population are fairer and more practicable. This is a very important part of the business improvement.

The Industrial Gains

Secretary Wallace gives credit for the gain in farm income to the increase of industrial production and consumption in the cities. The following table shows comparative figures of production in the first quarter of this year and last, in typical industries making non-durable goods, consumers' durable goods, and capital goods, i. e., goods to be used in business for purposes of further production:

	First Quarter 1935	First Quarter 1936	Per cent Change
Consumption Goods:			
Cotton consumption, bales	1,513,000	1,657,000	+ 9.5
Silk deliveries, bales	133,522	107,048	— 19.8
Rayon deliv., 1923-25=100	372.0	429.7	+ 15.5
Wool consumption, lbs.	149,000,000	159,000,000	+ 6.7
Boot & shoe prod., pairs	94,707,000	98,160,000	+ 3.6
Gasoline consumption, bbls.	86,491,000	95,150,000	+ 10.0
Consumers' Durable Goods:			
Passenger car registrations	568,727	692,420	+ 21.7
Vacuum cleaner shpts., units	297,302	359,464	+ 20.9
Electric refrig. sales, units	432,521	570,959	+ 32.0
Washing machine shipments	342,669	403,126	+ 17.6
Electrical goods orders	$122,000,000	$153,000,000	+ 25.4
Residential building	$71,236,000	$123,885,000	+ 73.9
Capital Goods:			
Truck registrations	111,067	136,061	+ 22.5
Machine tool orders, 1926=100	60.3	109.4	+ 81.4
Public utility building	$19,067,000	$47,971,000	+151.6
Factory building	$21,322,000	$40,803,000	+ 91.4
Other non-residential bldg.	$86,726,000	$193,748,000	+123.4
Freight car orders, units	830	8,913	+973.9
Locomotive orders, units	9	73	+711.1
Steel rail orders, tons	189.592	423,291	+123.3
Foundry equipment, orders, 1926=100	60.3	91.6	+51.9

The table illustrates the course of recovery. In the industries making consumers' goods of everyday use and short life, which recovered first, the showing of improvement this year is not uniform, and the gain is moderate in percentage. The gains in consumers' durable goods are more impressive, and (not shown by the table) some of these industries are operating at or close to the highest figures in their history. The gains in the capital goods industries are the largest of all in percentage; on the other hand, their operations are still far below the pre-depression figures, and it is in them that most of the depression and unemployment are concentrated.

This analysis demonstrates that the improvement in the industries over last year can be traced to two quarters. The first is replacement of automobiles and other durable goods worn out during the depression, together with demand for other comforts and conveniences which many people have never enjoyed. These wants are being filled as rapidly as buying power increases, but they are far from satisfaction. The theoretical demand for motor cars and trucks for replacement alone this year, figuring the average life of cars in use at around 7½ years, is calculated at 4,100,000 units, and this takes no account of the accumulation of replacements which have been deferred for some years past, or sales to new owners, domestic and export. The limit to this type of durable goods business is not in the market, but in the buying power, or in other words in general economic conditions.

The Situation in Capital Goods

The second area of industrial improvement is in capital goods. The gains are qualified by the fact that the percentage increases are upon a low base, and the figures are not impressive in relation to the normal activity of these industries. Although building contracts have run fully 80 per cent above a year ago, the figures have been mildly disappointing by reason of their failure to show full seasonal increases from December through March. Preliminary reports, however, indicate that April will resume the upward trend, with a more than seasonal gain.

Even with the necessary qualifications the trend of capital goods activity is upward. The contracts for new factory buildings in the first quarter (see adjoining table) are the largest since 1930, and they include a wider variety of industries. Since the first of the year nearly fifty large projects for plant expansion and equipment buying, involving some $225,000,000, have been reported in Iron Age, and the list obviously makes no pretense to completeness, since the steel industry alone is expected to spend $200,000,000 this year, compared with $140,000,000 in 1935, and 20 public utility systems will spend $250,000,000, against $175,000,000. Among leading corporations which have raised or announced plans to raise new capital this year, for plant expenditure, are Republic, Wheeling, and Jones & Laughlin Steel, Continental Can, Owens-Illinois Glass, United Aircraft, Shell Union Oil, and others.

It will undoubtedly be agreed that as long as capital goods activity increases the business trend will be upward out of the depression. Fluctuations in consumers' goods will cause peaks and valleys in the curve, but the tendency will be for each peak to be higher. Of course the conditions necessary to stimulate capital goods activity are complex in the extreme, and the situation shows that present conditions are far from uniformly favorable. Business must have assurance that capital expenditures will pay for themselves, and hope of profits, and that hope is dampened by the tax burden, by high costs in many lines, by restrictions upon enterprise, and by incalculable interferences which unsettle all estimates of the future. Borrowers must have access to a capital market wherein funds may be obtained, and that market is not yet available to untried enterprises, since lenders as well as borrowers are influenced by the factors just stated. To be sure established corporations are now having no difficulty in refunding outstanding debts at lower rates, which is helpful.

All analyses of the situation come back to the importance of the capital goods industries.

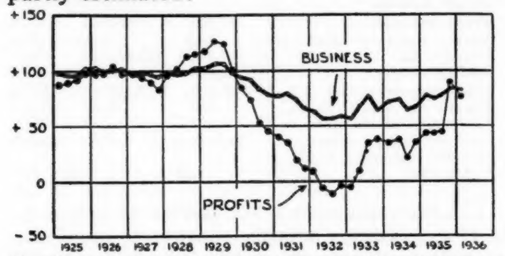
The moderate uptrend has been established largely because modernization and improvement are necessary to reduce costs, keep goods moving, and meet competition. The question is whether policies will be such as to encourage the improvement, by giving business men assurance that sound enterprises will face no greater obstacles than the natural and calculable hazards that exist in every endeavor.

First Quarter Profits

Reports to shareholders issued during the past month by representative industrial and merchandising corporations have shown, in a large majority of cases, a gain in earnings for the first quarter over those of the same period a year ago. While many companies had lower earnings in the initial quarter of 1936 than in the final quarter of 1935, in contrast with a normal seasonal rise, this is explained in part by the unusual activity caused in the motor and allied industries in the closing months of last year by the advance of the automobile season.

A tabulation of the statements of 245 leading corporations engaged in a variety of lines of industry and trade shows combined net profits, less deficits, of approximately $216,000,000 in the first quarter, as compared with $249,000,000 for the same companies in the preceding quarter and $152,000,000 in the first quarter of last year. Upon the net worth aggregating $9,305,000,000, the first quarter profits were at the annual rate of 9.3 per cent this year, against 6.5 per cent last year.

The aggregate gain in the first quarter of 1936 over 1935 amounts to 42.3 per cent, and follows a gain of 21.8 per cent for a similar group of companies in 1935 over 1934, and a net deficit in 1933, which was the worst first quarter of the depression and included the bank holidays of that year. These percentage gains, starting from such a low base, therefore tend to exaggerate the actual improvement that has taken place. The present rate of profits, according to an index based on average rate of return on net worth of 200 leading industrial companies, is still only about 75 per cent of the 1926 level, despite the heavy writing-down of capital and surplus, and revaluation of assets that have been made in recent years and that automatically increases both reported profits (by lowering depreciation charges) and the calculated rate of return. This index is given in the chart below, which shows over a period of years the trend of quarterly earnings after adjustment for seasonal variation, with the latest figure partly estimated:



Quarterly Index of Industrial Corporation Profits and The Annalist Index of Business Activity. 1926 = 100.

FIRST QUARTER INDUSTRIAL CORPORATION PROFITS

Net Profits Are Shown After Depreciation, Interest, Taxes, and Other Charges and Reserves, But Before Dividends.
Net Worth Includes Book Value of Outstanding Preferred and Common Stock and Surplus Account at Beginning of Each Year.
(In Thousands of Dollars)

No.	Industry	Net Profits First Quarter 1935	Net Profits First Quarter 1936	Per Cent Change	Net Worth January 1 1935	Net Worth January 1 1936	Per Cent Change	Annual Rate of Return % 1935	Annual Rate of Return % 1936
1	Autos—General Motors	$ 31,510	$ 52,464	+ 66.4	$ 872,485	$ 930,667	+ 6.7	14.4	22.7
5	Autos—Other	7,296	13,537	+ 85.5	191,271	219,730	+14.8	15.2	24.6
23	Auto Accessories	14,048	13,398	— 4.6	229,072	250,911	+ 9.5	24.4	21.3
5	Baking	3,000	4,366	+ 45.5	226,760	227,107	+ 0.2	5.2	7.7
8	Building Materials	1,176	1,524	+ 29.5	207,304	208,048	+ 0.4	2.4	2.9
13	Chemicals	22,739	29,879	+ 31.4	981,036	1,005,959	+ 2.5	9.2	11.9
9	Coal Mining	1,785	1,340	— 30.0	113,406	95,467	—15.8	9.6	5.6
5	Drugs and Sundries	1,326	1,807	+ 36.2	58,304	59,968	+ 2.9	9.2	12.0
6	Electrical Equipment	7,991	12,490	+ 56.3	586,902	598,418	+ 2.0	5.6	8.3
16	Food Products—Misc.	16,166	18,356	+ 13.5	556,646	562,888	+ 1.1	11.6	13.0
9	Household Gds. & Sup.	7,540	6,583	— 12.6	172,088	178,138	+ 3.5	17.5	14.8
1	Iron & Steel—U. S. Steel	D-2,174	3,376	+	1,840,532	1,564,373	—15.0	......	0.9
17	Iron & Steel—Other	8,866	6,275	— 29.2	826,034	865,086	+ 4.7	4.4	2.8
11	Machinery	1,636	3,008	+ 83.8	84,611	87,339	+ 3.2	7.7	13.8
7	Merchandising	144	1,000	+594.4	100,415	101,708	+ 1.3	0.5	4.0
7	Mining, Non-ferrous	2,396*	2,854*	+ 19.1	96,139	95,843	— 0.3	10.0	11.9
6	Office Equipment	3,272	4,092	+ 25.1	118,426	118,301	— 0.1	10.8	13.8
8	Paper Products	681	889	+ 30.5	57,837	57,926	+ 0.2	4.8	6.1
17	Petroleum	5,831	17,747	+204.4	1,124,214	1,136,836	+ 1.1	2.0	6.2
5	Printing & Publishing	2,256	2,395	+ 6.2	59,882	60,379	+ 0.8	15.0	15.8
5	Railway Equipment	D-64	582	+	85,431	82,020	— 4.0	......	2.8
9	Textiles	1,708	2,122	+ 24.2	58,654	59,961	+ 2.2	11.6	14.0
31	Misc. Manufacturing	9,735	9,925	+ 2.0	351,930	377,876	+ 7.4	11.0	10.5
21	Misc. Services	3,113	6,295	+102.2	349,459	360,067	+ 3.0	3.6	7.0
245	Total	$151,977	$216,304	+ 42.3	$9,348,838	$9,305,016	— 0.5	6.5	9.3

D- Deficit. * Before certain charges.

It will be seen that either a rise or decline in business activity usually causes a much sharper change in business profit, because of the narrow margin of profit and the fact that total charges do not expand or contract proportionately with volume.

Profits Trend in Major Industries

An examination of the accompanying tabulation will show that most of the industrial groups in which several representative companies have now reported enjoyed an improvement in earnings for the first quarter this year as compared with a year ago. The improvement was by no means uniform, however, for the results of many concerns ran counter to those of their respective industries. About three out of every ten individual companies had a decline in earnings instead of an increase, and one out of every ten was still in the red. As pointed out heretofore, these tabulations of a limited number of leading organizations merely indicate the trend of earnings and do not provide an accurate measure of average return for all industry.

The sharpest percentage gains in the table are found in the "heavy industries,"—which had suffered the sharpest drop in earnings during the depression,—such as automobiles and petroleum, machinery, electrical equipment and railroad equipment. The United States Steel Corporation turned a deficit last year into a small profit this year, although earnings of a number of other steel companies were lower. A good showing continues to be made by the chemical, drug and office equipment industries.

Relatively smaller gains, mixed with some declines, were reported by the industries making consumer goods, such as baking and miscellaneous food products, household goods and supplies, paper, printing and textiles, also merchandising. Some of the durable goods industries, notably building materials, are still lagging, and coal mining earnings were down.

It is important to note that the reports for the first quarter of 1936, like those for the full year 1935, show that the percentage increase in profits was much sharper than the increase in profit margins, because of the expansion in volume of sales. This is of course a healthy sign and one of the essentials to the recovery or real prosperity, since the expansion in gross receipts means more goods produced, more materials consumed, more employment of labor and larger payrolls. Although prevailing prices of certain commodities are somewhat higher than a year ago, this was in most cases only a minor factor in the expansion of dollar sales, the major factor being the increase in physical volume. Higher rates of operation lower the unit costs of production and distribution, and permit lower selling prices also, thus giving further stimulation to buying. Under these conditions, the more active use of invested capital may readily yield a better return, even though the unit margin of profit be somewhat smaller.

Relatively few concerns include sales in their interim reports on earnings, but the following partial list of the more important companies whose figures have been published will illustrate the marked expansion that was made by many enterprises in the first quarter as compared with a year ago:

Change in First Quarter Sales, 1935-1936

Manufacturing		Merchandising	
Air Reduction Co....	+34.5	American Stores Co...	— 3.3
Allis-Chalmers Mfg...	+73.8	Barker Bros. Corp....	+30.0
Amer. Colortype Co..	+12.3	Crown Drug Co......	+13.5
Amer. Writing Paper	+ 4.1	Edison Bros. Stores..	+18.1
Atlas Powder Co.	+16.8	Marshall Field & Co.	+ 2.8
Caterpillar Tractor Co.	+59.0	W. T. Grant Co......	— 1.6
Chrysler Corporation.	— 1.0	H. L. Green Co......	+10.0
Continental Oil Co...	+ 8.9	Interstate Dept. Stores	+ 7.7
Fisk Rubber Corp...	—23.9	Jewel Tea Co.	+ 5.6
Flintkote Company..	+54.4	Kats Drug Co.........	+ 2.8
General Electric Co...	+27.3	S. S. Kresge Co......	+ 1.5
General Motors Corp.	+35.7	S. H. Kress & Co....	+11.7
Granite City Steel...	+39.6	Kroger Groc. & Bak.	— 1.2
Hercules Powder Co.	+ 9.5	Lane Bryant, Inc. ...	+10.0
Interlake Iron Corp..	+20.8	Lerner Stores Corp...	+ 8.6
Inter. Cement Corp. ..	+30.6	McLellan Stores Corp.	+ 2.6
Inter. Printing Ink..	+16.3	Melville Shoe Corp...	+25.1
Johns-Manville Corp..	+23.6	Montgomery Ward...	+ 5.3
Kimberly-Clark Corp.	+13.6	G. C. Murphy Co.....	+11.3
Link Belt Co.........	+47.5	National Tea Co......	+ 2.5
McGraw-Hill Pub. ...	+14.8	Neisner Bros., Inc....	+ 7.2
McKesson & Robbins	+13.5	J. J. Newberry Co...	+ 3.6
Maytag Company.....	— 9.9	J. C. Penney Co......	+ 8.5
Mengel Company.....	+24.6	Peoples Drug Stores..	+ 9.0
Minn.-Honeywell Reg.	+53.9	Safeway Stores, Inc..	+19.2
Noxema Chemical Co.	+18.1	Sears, Roebuck & Co.	+14.7
Otis Elevator Co.....	+33.6	Spiegel, May, Stern Co.	+24.4
Phillips Petroleum...	+19.0	Sterchi Bros. Stores..	+31.4
Poor & Company....	+25.5	John R. Thompson..	+ 4.7
Revere Cop. & Brass	+15.6	Waldorf System, Inc.	+ 6.8
Scott Paper Co.......	+11.0	Walgreen Co.	+ 3.8
Seaboard Oil Co. (Del.)	+37.1	Western Auto Supply	— 0.4
Shell Union Oil......	+ 9.1	F. W. Woolworth Co.	— 0.3
Skelly Oil Co........	+21.3		
Stewart-Warner Corp.	+13.2		
Thatcher Mfg. Co....	+68.8		
Tide Water Assoc. Oil	+13.5		
Twent. Cen.-Fox Film	+12.8		
Union Oil Co.	—17.2		
U. S. Hoffman Machy.	+21.7		
Westinghouse Electric	+29.6		
Wheeling Steel Corp..	+ 7.8		
Yellow Truck & Coach	+61.5		

Railroad freight and passenger traffic has increased moderately this year. While the final March statistics for all Class I roads have not yet been published, the reports available indicate that total revenues for the first quarter increased from $800,000,000 to about $908,000,000, or by 13.5 per cent. Higher operating expenses and taxes absorbed about $88,000,000 of the increase in gross, leaving $20,000,000 to be carried to net. The net operating income, which is a composite derived by combining the earnings of the strong systems with those of the numerous weak lines, increased from $85,000,000 to about $105,000,000, and represented an annual rate of return upon property investment of 2.1 per cent this year against 1.69 last year. After payment or accrual of interest charges, there was an indicated deficit before dividends of $28,000,000, as

against a deficit of $45,000,000 in the first quarter last year.

Further discussion of the present railroad situation is contained in the following article on the new tax proposals.

A group of reports by 25 operating systems producing electric light and power, gas, and other services, shows that for the twelve months ended with March, total revenues increased about 4.3 per cent over the preceding year and net income after charges increased 7.5 per cent. Fixed charges for interest are now showing the benefits of the large amount of bond refunding at lower rates done by the public utilities in the past year or so, which have helped to offset the continued increase in their tax levies.

Money and Banking

There was no marked change in money conditions during the month. Rates quoted in the open market remained generally at the low levels prevailing for some time, with the discount basis for new 273-day Treasury bill offerings shading from around 0.126 per cent at the end of March to 0.093 in the last week of April, compared with the year's low of 0.074 per cent in February.

Monetary gold stocks increased slightly to a new peak of $10,221,000,000, not including $18,000,000 purchased in France but not yet received in this country. The excess of member bank reserves above legal requirements rose sharply to $2,690,000,000, due mainly to Government disbursements out of balances previously accumulated at the Reserve Banks; although the total excess was still $600,000,000 under the maximum of last December, it was well above the mid-March total of $2,300,000,000, which, as the current Federal Reserve Bulletin significantly remarks, was "sufficient to provide the basis for expansion of credit far beyond present or prospective needs". On April 29 the Treasury still had nearly $700,000,000 on deposit at the Reserve Banks.

Distribution of Excess Reserves

In its annual report for 1935, issued during the past month, the Federal Reserve Bank of New York comments upon the growth of excess reserves over the past two years, and presents interesting data as to their distribution which have a bearing upon the problem of credit control. Our readers doubtless are familiar with the provisions of the Banking Act of 1935 authorizing the Board of Governors of the Federal Reserve System to increase the reserve requirements of member banks to not more than twice their present amount, if necessary to avoid injurious expansion of credit. During recent months there has been much discussion of the problem of excess reserves and of the possibility of their becoming the basis of excessive credit expansion. Many well-informed people have felt that it would be a wise precaution to raise reserve requirements sufficiently to reduce the excess to more manageable proportions, and on February 12 this year the Federal Advisory Council recommended to the Reserve Board that action along these lines be taken.

One aspect, however, of the problem about which there has been uncertainty, at least so far as the general public is concerned, relates to the question as to how broadly the excess reserves are distributed. There has been some doubt as to whether an advance in reserve requirements might not bear down with undue weight upon many banks whose reserve position was not as easy as the aggregate totals might indicate. On this point the figures published by the New York Reserve Bank are enlightening. Taking the banks of the Second Federal Reserve district as the basis for study, it was found that only 22 banks out of a total of 793 had reserve balances and deposits with correspondents amounting to less than 25 per cent in excess of their requirements; only 51 banks had such funds amounting to less than 50 per cent in excess of their requirements; and only 133 banks, or about one-sixth of all member banks in the district, had funds on deposit in the Reserve Bank or with other domestic banks amounting to less than double their reserve requirements. It is true that a part of the funds on deposit with other banks should be regarded as normal working balances, and should not be regarded altogether as surplus funds; nevertheless, the findings are indicative of a broad distribution of surplus reserves through the district, and, insofar as the district may be considered typical, of a similar broad distribution throughout the country.

Trend of Member Bank Credit

At the member banks, the trend of outstanding credit was moderately upward during the month. Total loans and investments of the weekly reporting institutions increased about $150,000,000 during the four weeks ended April 22, and on the latter date were nearly $2,000,000,000 above a year ago. Comparing the totals for the month, increases were principally in brokers' loans, and in holdings of securities other than U. S. Government issues. Compared with a year ago, the increases were very largely in holdings of U. S. Government and guaranteed securities. Demand deposits adjusted increased $416,000,000 during the month, and were about $2,000,000,000 higher than last year at this time.

The item classified as "other loans," generally considered roughly indicative of commercial borrowing, experienced a rise of $237,000,000 between the February low and April 15,

falling off slightly in the following week. The increase during April in this classification of loans, over similar figures in April last year, averaged $200,000,000, a somewhat larger gain than has been shown heretofore.

Bond Market and Foreign Exchange

Outstanding high grade bonds continued firm during the month, but second grade issues reflected weakness in the stock market. There was some indication of indigestion in the market for new issues which has been crowded heavily of late by new offerings at comparatively high prices. In the U. S. Government bond market, fifteen of the sixteen long-term issues sold at record high prices around the middle of the month, but prices eased off some before the close.

New capital issues for the first quarter aggregated $1,481,000,000, according to the Commercial & Financial Chronicle. Of this total, $145,000,000 represented new money for industrial expansion, compared with $20,000,000 in the corresponding period of last year. By far the greater part of the new flotations, or $1,121,000,000, represented refinancing largely to take advantage of low money rates.

The feature of the foreign exchange market was weakness in French francs which sold at or below the gold point during the greater part of the month. This period of weakness, which began with the reentry of German troops into the Rhineland March 7 and undoubtedly was influenced by the French elections on April 26 and May 3, was accompanied by a substantial further loss of gold by the Bank of France, chiefly, it would appear to London, inasmuch as gold purchases in Paris for shipment to the United States have been moderate. Late in the month the Swiss franc likewise displayed weakness.

The question is of interest as to whether devaluation and return to a fixed gold basis by the gold bloc countries would lead to substantial repatriation of capital from this country. No doubt some return movement would develop; however, in view of the business prospects here and the political uncertainties abroad, there will be a strong inducement for many foreign investors to keep their funds on this side of the Atlantic. Moreover, we have ample funds to spare. The development to be feared is not a return of European capital attendant upon real improvement in conditions in Europe, but new confusion in the exchanges.

On April 27, the Government of Poland abandoned the free gold standard by placing an embargo upon gold exports and introducing a system of foreign exchange control.

The Pending Tax-Bill

The general plan of the tax-bill as prepared by the Treasury was discussed in these columns last month. The sub-committee already had proposed certain alterations, excepting banks, other financial corporations and insurance companies, also in regard to corporation earnings which by reason of state laws or loan contracts could not be paid out as dividends. These recommendations were adopted by the Committee, and further provision was made for amortizing long term and funded indebtedness outstanding prior to March 4, 1936, over a period of not less than five years, to the extent of the excess of the same over the corporation's earned surplus and undivided profits, subjecting such payments to an optional flat tax of 22½ per cent, instead of the graduated rates, which run as high as 42½ per cent.

The computation of the tax is an exceedingly complicated task. The fundamental difficulty is that the tax rates are graduated, depending on the ratio of undistributed net income to "adjusted net income" (i.e., total net income, less certain exempt bond interest), as shown in Schedule I (for net incomes of not over $10,000) and Schedule II (for incomes over $10,000). As the undistributed net income is the adjusted net income, less dividends paid, *and less the tax,* the undistributed net income cannot be determined until the tax has been determined; and the tax cannot be determined until the undistributed net income has been determined—thus presenting a problem which hardly could be solved without a resort to higher mathematics.

This brief description barely suggests the complexities of this measure. We shall not attempt to enter further into the maze of details, and are not prepared to believe that the bill will be enacted in its present form.

In making the named concessions the Committee has yielded to vigorous protests offered during the eight days of public hearings, although Treasury representatives have opposed them all, arguing that the Treasury needed the estimated revenues and that the plan was more equitable than existing law. Chairman Doughton, of the Ways and Means Committee, speaking of the changes in taxes on debt-payments, said that they might have the immediate effect of lowering the tax yield, but would "strengthen the income source." He is quoted as adding that he "agreed to the contention that without this relief many corporations would be forced into liquidation."

The action of the Committee in this respect is a recognition that it is not only prudent business policy, but sound public policy, for every corporation in years of normal income to reduce its indebtedness. This policy safeguards the business and makes for social security. The Government might very well abstain from penalizing such payments even to the extent of the minimum 22½ per cent, for unlike income consumed by recipients, income thus disposed of is devoted to social purposes.

The concentration of taxation upon business and business leaders inevitably affects every

part of the vast organization by which every person gets his living. When any part gives way, other parts are weakened, and this is especially true when the entire organization has been weakened by more than five years of strain and losses. Ill-advised taxation may result in lower, instead of higher, revenues, and worse than that, *in less employment.*

The Sum of Opposing Arguments

The broad argument against the measure, as made to the Committee during the hearings, was that it does not recognize the hazards of modern business, and particularly of modern industry, with its large investments in specialized equipment and its constantly changing technique; and would imprudently limit the authority of ownership and management in vital matters of policy. This contention is illustrated by the rigid terms of even the concessions granted upon debt-payments, applying as they do to all corporations alike, regardless of varying conditions among individual corporations and kinds of business; also as related to the changes that may occur over a five-year period. The rapid changes in products, methods and equipment give increasing uncertainty to all allowances for capital depreciation and obsolescence. Past estimates of this kind are themselves obsolescent. No business is secure without a management alert to every development and having ample and readily available reserves.

Speakers in the hearings stressed the wide swings in inventory values of raw materials, unfinished goods and unsold stock, which must be valued at cost or the market, and the part they play in yearly profit figures. Tables were given showing a one year range of raw materials from a decline of 19 per cent to a rise of 80 per cent. In 1920-21 thousands of business men were ruined by the fall of inventory values. Good corporation practice requires ample reserves against inventory losses.

Business men before the Committee were in agreement that the measure would make it harder for young enterprises of small capital to make headway against established competitors who had name, good will and ample reserve accumulations. In the past, new enterprises of merit have built up their productive capacity from small beginnings by the savings of new processes which they have introduced, and which have enlarged the purchasing power of the public. This will be much more difficult under the proposed tax system.

Bankers urged that it would result in increased uncertainty in relations with customers dependent upon bank loans for working capital and upon current net earnings for means of payment. The relief conceded in the bill does not apply to new indebtedness. The new taxes will be more than a prior lien: they will create a powerful motive for distributing profits instead of paying off debts, and naturally will require an increase of caution in making loans.

Taxation policies should not handicap industrial progress. This was the main plea presented at the "hearings." The sum of the objections was that the restrictions will mean less freedom, less initiative, less exercise of judgment to suit each case and circumstance, more rigidity and routine, more waste and lost motion, greater burdens upon industry and a slowing down of industrial and social progress.

An Example from Railroad Regulation

In the discussion of the tax-bill in these columns last month, mention was made of certain utterances of the Interstate Commerce Commission which seem to imply that in the light of present knowledge it might have been better policy in past years to have permitted the railroads to earn a little more money than was allowed, but for the express purpose of reducing debt. This mention has excited inquiry, and prompts a further statement, not for criticism but for the lesson implied.

The Interstate Commerce Commission has been regulating the railroads since 1887, and by common agreement there is greater need for some coordinating and supervisory authority over railroad operations than over any other kind of business. The need for just and equal treatment of individuals and localities by the railroads is more important than any other business relationship. In character the membership of this Commission probably has been above the average of public officials, outside of the judiciary. The tenure of office has been fairly long. But the weakness of governmental control over business affairs has been illustrated by the division of authority between the Commission and Congress.

Under this joint control the railroads have reached a sorry plight. In 1932 total operating revenues were 51.2 per cent of the 1923-1925 average and in 1935 they had recovered to only 56.5 per cent. In every year of the last four, 1932-1935, the Class I railroads as a group have had a deficit after fixed charges, and at the close of 1935, 86 companies, operating about 27 per cent of the total mileage, were in receivership or bankruptcy. Moreover, in efforts to reduce expenses, maintenance costs have been closely trimmed. In the language of Mr. Eastman, the Emergency Coordinator, "much railroad property is down at the heel." In the nine years 1922-1930 the average of yearly capital expenditures was $782,000,000, while for the five years 1931-1935 it was down to $207,000,000. In 1924, average number of employes was 1,751,362; in 1935, 994,078. Of course, the business depression has been an important factor in this decline of traffic, but informed persons believe that railroad prob-

lems have had much to do with the business depression, and especially its long continuance.

Railroad regulation has been in gradual development since 1887. It has met with many difficult problems, and in 1920 railroad law was revised generally. The transportation act of that year was drawn by able men who had been honest critics of railroad management. One of the problems that had baffled both Congress and Commission was, how to allow all railroads to earn reasonable compensation without allowing some of them to earn *too much*—a problem not restricted to railroads, as we shall see further on. In the act of 1920 an attempt was made to solve this problem, by means of the "recapture" provision, an explanation of which is quoted below.

The Act of 1920

Before giving the quotation we will add, by way of further introduction, that this theoretical solution which has failed to solve anything was based upon an engineering survey and valuation of all railroad property, which even yet is not completed, but up to date has cost about $200,000,000. The valuation had been begun some years earlier, with the senior LaFollette as prime mover, was already under way, and was expected to reveal oceans of water. The final valuation as determined by the Commission is obtained by taking account of original cost, cost of reproduction new less depreciation, cost of lands, sum of working capital, materials and supplies on hand, and all matters appearing to have relations to the going-concern values of the properties. The act of 1920 contemplated that upon the aggregate valuation of all the properties, aggregate earnings would be permitted, (if the companies could make them) up to a "fair return," which the act named as 6 per cent for the start-off, but was to be fixed from time to time by the Commission. This was the limit upon the total sum to be allowed all the companies: if some of them earned more, others would have less; but one-half of the surplus net earnings of the more prosperous companies was to be "recaptured" for a "fund," from which loans would be made to the "deserving poor."

The first and only change in the rate fixed by the Commission was from 6 to 5¾ per cent, but the aggregate net earnings have not reached the lower rate in a single year from that day to this. The average rate over the entire period, 1920-1935 inclusive, has been 3.17 per cent; for 1920-1930 3.81 per cent, and for 1931-1935 1.76 per cent. This is the record of the so-called "guaranteed return," which has caused numerous persons to work themselves up unduly. Incidentally it may be mentioned that the $200,000,000 has not revealed "water" as expected, or that what "water" there was had any effect upon charges or earnings. No doubt it is worth something to have the valuations, but up to date the "recapture" efforts represent the only known use of them. The Valuation Bureau is still functioning, with a staff as of December 1, 1935, numbering 304.

Failure of Recapture

In 1930 the Commission in its annual report to the Congress recommended repeal of the recapture clause and in 1931 repeated the recommendation. In 1932 it renewed it once more, and in doing so stated that at public hearings before the Committee on Interstate and Foreign Commerce of the House of Representatives repeal had been favored by "representatives of the carriers, shippers, State Commissions, railroad labor and investors," adding: "there was no opposition."

After these preliminary statements, the 1932 report summarized recapture experience as follows:

> Both the present rate-making rule and the recapture provisions were founded upon the theory that the rates charged by the railroads could be so adjusted—moved up and down from time to time—as to maintain a comparatively stable level of aggregate earnings. These aggregate earnings would provide a fair average return, but the more favorably situated railroads would earn more than a fair return, while those not so well situated would earn less. As a partial correction of these anticipated results, provision was made for recapture by the Government of one-half of the income earned by a railroad in any year in excess of a fair return, the funds so recaptured to be loaned to the less prosperous carriers.
>
> Accepting the premises on which it was based, this was a logical plan; but in fact the premises were unsound. Railroad earnings reflect general economic conditions very closely, and to the extent that such conditions fluctuate railroad earnings will fluctuate, and it is impracticable to avoid these fluctuations by moving railroad charges up and down. To attempt this would mean higher rates in times of depression and lower rates in times of prosperity. Perhaps it was assumed, when the present section 15a was devised, that we had reached an era when economic conditions would remain stable; but if so, no such thought is any longer entertained. Another important factor which was then unanticipated or disregarded was the competition of other transportation agencies which has developed so rapidly in recent years, to the detriment of railroad earnings.

Other comments followed, of which one was that it did no good to grant loans to the roads that could not make money on a competitive basis, because it only got them more deeply into debt with no prospect of getting out.

One comment is especially pertinent to the pending tax bill, because it touches upon the subject of annual income fluctuations and the importance of corporation reserves. Upon this the Commission said:

> The recapture provisions make no allowance for fluctuations in earnings. If a carrier is fortunate enough to have excess income in any year, half of that excess is subject to recapture, regardless of the fact that it may be completely offset by deficiencies in succeeding years. This was the most serious defect in the recapture logic, but the plan has been shown to be subject to other objections of a practical nature.

Further on in the same discussion the report says that the "strongest argument in favor of retaining recapture" is that there are "a comparatively few railroads which have enjoyed extraordinary prosperity," but adds that "there

is no telling how long this will be so," and offers various reasons for doubting the wisdom of any attempt; finally saying:

Nor is it at all certain that it is a bad thing for the country that some railroads should be able to earn more than ordinarily generous returns, in view of the hazards to railroad earnings which have become so clearly manifest in the light of recent events. The opportunity to earn more than ordinary profits in exceptional cases is an inducement, when such hazards exist, to investment which might not otherwise be made.

* * * We renew our recommendation that the recapture provisions be repealed from the beginning. The railroads are facing a difficult future. They have much to contend with and the prospects are not alluring. Repeal of recapture will remove one dark cloud which hangs over their credit, and the removal will benefit rather than harm the country.

The above quotations are testimony from the oldest permanent commission of the Government, and the most important, and this testimony is supported by the act of Congress repealing the recapture provisions, in 1933. It testifies to the result of an experiment in arbitrary and discriminating levies quite similar to, but much less dangerous than, the one now proposed for all corporations. Everything said about the fluctuations of railroad earnings, including the sage observation that "it might not be a bad thing" to have some of the railroads prosperous, "in view of the hazards of the business"—is equally applicable to industrial corporations.

Official Endorsement of Sinking Funds

Following the repeal of the recapture provisions, the Interstate Commerce Commission began an agitation for sinking funds created from earnings for the gradual reduction of debts before maturity. Furthermore, the President gave a public expression of endorsement, summarized in the "Railway Age" of January 13, 1934 (p. 51) as follows:

President Thinks Rail Earnings Should be Adequate For Sinking Funds

President Roosevelt has let it be known that he is heartily in favor of the position taken by the Interstate Commerce Commission and others that the railroad companies should set up sinking funds out of net income for the purpose of retiring a part of their funded debt. The Commission's recommendation was that this be done in part before maturity. In fairness to the companies, however, the President also believes that this means that regulatory bodies ought to seek to make it possible for railroads and utilities to earn enough to set up sinking funds and that for this reason rates should not be reduced so much as they might be otherwise. The President feels that one of the chief troubles of the railroad financial situation is that so large a proportion of their capital structure has been in the form of mortgage indebtedness instead of stock and that the debts are constantly refunded instead of paid off, and that fact is illustrated by the condition that existed last spring when a number of railroads that had been solvent for many years were faced with receivership and probably other major carriers might have been in a similar situation within six months if conditions had continued. In his opinion such a situation would have been caused by inability of the railroads to meet the interest on their mortgage debt whereas if their fixed charges had been less they could have faced the situation more easily because dividends may be passed without receivership resulting.

This comment is so obviously sound that it should be convincing to all readers. It is proper to say in this connection, that after the passage of the act of 1920, the investing public—for some reason apparently obscure to the Commission and Congress—developed a pronounced preference for railroad bonds as compared with railroad stocks, and railroads needing capital have thought it advisable to conform to this preference.

We have given this review of the recapture experiment for several reasons: first, it is pertinent to the present critical railroad situation; second, it has an obvious bearing upon the pending tax-bill; and, finally, it affords a practical illustration of the inherent difficulties that attend upon governmental regulation of business. It is not offered as proving that there should be no regulation, but as showing that such proposals should be worked out carefully and not rushed through under a time limit as emergency legislation. This experience shows that Congress, with the advice of a Commission, may adopt a long-considered and highly-important policy, and later be advised by the Commission that although the policy would have been entirely "logical" if the premises had been sound, (alas!) "the premises were unsound," and the act should be repealed.

The Rise of Corporation Profits

Advocates of the pending bill have laid emphasis upon the rise of corporation profits especially in the last year, as indicating that they properly subject to more taxation. A representative of the Treasury addressing the committee said that virtually there was nothing else to tax, and that corporation profits had increased 40 per cent. Certain casual comment has been to the same effect. A "40 per cent increase" seems large indeed unless you know more about it. A table in these columns last month, giving the net earnings of 2,010 corporations in 1934 and 1935, showed a net profit of 42 per cent, and possibly this table was the basis of the "40 per cent" statement, but accompanying comment pointed out that the 2,010,—out of over 500,000 corporations doing business — were leading ones in their lines, whose stocks and bonds are listed on public exchanges, and who are under obligations to make public reports.

To be more explicit: the table of earnings published last month gave the earnings of 2,010 corporations in the full year 1935 and compared them with the earnings of the same corporations in the year 1934. The table included all reports available in the first quarter of 1936. This comparison showed a net profit gain from 1934 to 1935 of 42 per cent. However, in view of the fact that the reports available represented so small a proportion of the total number of corporations in business, and because past compilations have shown that the early reports are not a true criterion for all corporations, an explicit warning was given that the

showing should be taken, not as an indication of aggregate results, but only as indicating the general trend. Thus in our April number 1935, a table was given showing that 1,935 corporations reporting in the first quarter of 1935 showed net earnings in the year 1934 31.8 per cent higher than for the same corporations in 1933, but subsequent information has indicated that all corporations together had no net earnings in 1934.

These reports were made public by the corporations voluntarily or under stock exchange rules, but complete reports of corporation earnings can be had only from the reports of the United States Treasury, and for the full calendar year; moreover, they do not become available to the public until a year or more after the end of each year. The quarterly reports and comparisons are given in these columns and elsewhere for their immediate news value. In this instance they indicate a rising trend in volume of business and profits.

Earnings Over Four Years

We also gave last month the final Treasury figures for all corporation earnings from 1921 to 1933, which showed for 1930 a net aggregate profit of 1 per cent on their aggregate gross income of 136 billions of dollars; and that in the years 1931, 1932 and 1933 they had aggregate net deficits of 2.9 per cent, 6.6 per cent and 2.8 per cent respectively on their aggregate gross incomes, amounting in all to a loss in the four years of nine and one-half billions of dollars. The Treasury figures for 1934 have not yet been published, but the Department of Commerce last December issued a calculation of the total national income in 1934, in which it reached the conclusion that corporate and private business together had a net aggregate deficit of $1,628,000,000. On the strength of this official estimate it is reasonable to conclude that in 1934 the corporations as a body again operated with a deficit.

Recurring now to the "40 per cent gain" which was the basis of the Treasury adviser's advice to the Ways and Means Committee, it is evident that the figures used do not have the implied significance. The corporations as a body had no net income in 1934, and no percentage return can be calculated on zero. The statement was erroneous and misleading.

Of course, this does not mean that none of the corporations had any profit in any one of the years named: the facts are that when the profits and deficits are put together the latter exceed the former. The Department of Commerce calculation shows this to be true on the aggregate of *all* business in 1934. However, since this calculation does not show corporation earnings separately, suppose it be assumed that instead of having no aggregate profit in 1934, all corporations, as in 1930, made an average of one per cent on gross income. In that case an increase of 40 per cent would give 1.4 per cent as the profit share of the corporations in the total value of their product in 1935. Is this an excessive margin of profit from which 22½ to 42½ per cent should be taken as a toll on debt-payments, or on any expenditures of earnings they may desire to make for improvements or development?

The Fortunes of Different Groups

Instead of thinking only of the elite group of corporations, suppose we consider several groups in somewhat different circumstances? Assume that all corporations be divided into four groups, as follows: (1) the lowest group, composed of companies that are definitely losing money—still struggling, but probably destined (unless a miracle of revival happens) to soon pass out of the picture; (2) next above, a group that is about breaking even, but not making money, hopeful but dependent upon the general trend; (3) making some money, but position not assured, also dependent on the general trend; and, (4) the group of leaders in their respective lines—the low-cost producers, with up-to-date equipment and methods, ample reserves, capable management, able to outlast most of their competitors in any weather that may come. These four groups must be envisaged distinctively and together in order to have a true picture of the business situation. They are not operating in air-tight compartments but are doing business with each other. Many of the first three are selling materials and capital goods to the fourth, which makes the pace in all development. It is impossible to suppress or hobble the leaders without affecting all, and what will be the effects of any policy unfavorable to enterprise, upon the four groups severally, and upon employment and social welfare?

An Equality Argument

One of the arguments offered for the bill is that it will establish "equality" of treatment as between earnings paid out to shareholders and earnings retained in the business. Of course, this argument is not in behalf of the shareholders, but in behalf of the Treasury, which seems to feel that new stores of wealth have been discovered and that the essential function of business is to pay taxes. The principal function of business, as taught by Adam Smith, master of economic science, is to supply the needs and wants of the people, and to provide employment in doing so. He said that Governments in levying taxes should interfere with business as little as possible, and that they would get more revenues by sharing in the prosperity of the people.

The greatest error of the tax-plan is in this emphasis upon taxes, with the incidental requirement that corporation earnings shall be paid out to shareholders, instead of being retained for debt-payments or other business uses. Earnings retained in the control of a

company can be used only for business purposes, which means for the employment of labor and the production and distribution of wealth. If used to cancel debt, they will strengthen the business structure; if invested in bonds they will finance enterprise; if seemingly idle in a bank-deposit, they are available for business uses, not only by the depositor but by others; or if unemployed, they will depress interest rates and in this way be a potent influence for business revival; and, finally, however and by whomsoever they may be employed, they will give employment to labor. There is no productive employment for capital but by the employment of labor. You cannot dig a ditch or lay a wall or turn a furrow or expend a dollar, without employing labor.

For these reasons it is sound public policy to favor the retention of business earnings in business uses. It is not only a sound policy, but a progressive, enlightened and just policy to do so; for while capital shares in the increased production resulting, its share is very small, as proven by the record of corporation profits given in these columns last month, viz: over the thirteen years 1921-1933, 2.6 per cent of the sales value of their products; in 1935, for 390 leading corporations, reporting in the first quarter of 1936, 5.4 per cent of aggregate sales.

The Authentic Figures for Profits

There is no longer any excuse for ignorance or misrepresentation of the profits of corporations; for all corporations are now required to make detailed reports to the Treasury, and the latter has an expert force of checkers and prosecutors. If it be said that the above figures are unduly affected by averages, and misleading as to the large corporations, the assertion certainly is the reverse of true as to the 1935 figures now available. It is refuted by the figures for particular groups. Thus, while all companies reporting in the first quarter of 1936 upon earnings in the year 1935, show a profit average of 5.4 per cent of their total gross income, 19 steel companies, among which are the United States Steel, Bethlehem, Republic, National, Wheeling, Jones & Laughlin, and other big ones, show an average of only 1.9 per cent; fourteen meat-packing companies, including the "big four," show only 1.2 per cent; eleven manufacturers of cotton goods show a deficit of 1.3 per cent. Thus out of every dollar of gross income the steel companies paid out 98.1 cents for operating costs, including raw materials, interest and taxes, and the meat companies paid out 98.8 cents in like manner. Even this small margin of profit is widely distributed, for the United States Steel Company alone had at the close of last year 216,326 stockholders, and Swift & Company alone had 55,000 stockholders. United States Steel and subsidiaries had approximately 194,800 employes working throughout the year, and Swift & Company had about 60,000.

The steel and packing groups have been commonly represented as among the most highly monopolized of all the industrial groups, but here are the authentic figures of their profits. For many years the railroads played the star "monopoly" part, but above is given the percentage of their average net earnings for the last fifteen years, as computed by the Interstate Commerce Commission upon its own valuation of the properties, viz: 3.17 per cent.

Of all these reputed monopolies it seems fair to say that if they have the power to fix their own remuneration they are very moderate in their exactions; and if they have not the power to do so, they can hardly be considered very dangerous monopolies.

Exaggerated reports about the profits of the industries have been on the air for a long time. The official figures should silence them. It is for taxes on these profits that the modern industrial system as a whole is imperilled.

Profits of 1922-1929

One of the most common fallacies of the day is the random conjecture that extraordinary profits were made by the industries in the post-war boom period and invested to increase production, thus causing over-production and unemployment, breaking down prices, bringing on the depression, etc., etc., all of which has little factual basis. The volume of production was large, but the margin of profit was smaller than shown by any previous record, and so low that at the time it was frequently called an era of "profitless prosperity."

The Treasury figures show that from 1922 to 1929 inclusive the average profit of all corporations was but 4.7 per cent of the aggregate gross income, and in only one year rose as high as 5.2 per cent. In both 1928 and 1929 it was exactly 5 per cent. With an average of approximately 5 per cent of produced values retained by the corporation, it is evident that 95 per cent would be distributed elsewhere—in costs of production, including wages, material costs, taxes, etc., and possibly in lower prices to consumers; in short, *to the public*.

It is true that the narrow margin of profit and the doubling of wages stimulated the development of labor-saving methods, as might be expected, but it is not true that the depression began with the highly organized industries, as charged. It began with the fall in price of agricultural products, when the agriculture of Europe regained its pre-war rate of production and reduced its extraordinary importations from this country.

With a 5 per cent return on gross incomes, all industrial earnings retained in the industries for further development and growth obviously will yield to the corporation treasuries 5 per cent of the value of the increased production,

while 95 per cent of the increase will go to the public—not by any uncertain promptings of generosity, but by the simple processes of economic law. This, however, does not mean that the full 5 per cent will reach the stockholders. They share in the earnings only as they receive dividends, and if in any year the net earnings are not fully distributed as dividends, but in whole or in part are retained for use in the business, the stockholders to that extent will not participate in the distribution; moreover, of the increased production resulting from this policy in subsequent years, the corporation will be able to share only at the ratio between itself and the public in previous years, namely at the approximate ratio of 5 to 95, or one part for the corporation to 19 for the public, as appears above. Of course, as consumers of their own products and other products stockholders will share in the gains of industrial progress proportionately with all other consumers. It should be mentioned also, that out of these profits individual stockholders must pay their personal taxes, national, state and local.

The above record reveals the approximate average division of the industrial product over the last 15 years between industrial proprietors and the public, and the compensation of ownership for initiative, enterprise, the use of its capital, the services of organization, the risks of business losses, etc.

Looking to the public interest, could there be a more mistaken or shortsighted policy than that of forcing the distribution of earnings by law, instead of permitting them to remain and fructify in productive employment with distribution accomplished through a constantly rising standard of living?

The Automobile and Steel Industries

The foregoing is strikingly illustrated by the development of the automobile industry as described in these columns last month. By the retention of earnings for development that industry has been built up to afford more employment than any other industry in this country. Dividends have been relatively small. The net earnings have mainly gone into the improvement of methods and the vast plants that have no other value but what they can earn by supplying a public want. In the division of benefits from the rise of the automobile industry, between the stockholders and all others concerned, the latter have shared at a ratio far more favorable to them than 19 to 1.

A similar illustration is afforded by the report of the United States Steel Corporation for the year 1935; as follows: It had aggregate gross receipts from sales and otherwise of $758,893,126; paid out $251,576,808 as wages; had a profit of $1,146,708, which was .15 of 1 per cent of the gross income, paid a dividend of 2 per cent on its preferred stock (aggregate sum, $7,205,622) and nothing on its common, but has appropriated $35,313,455 for expenditures in 1936 upon improvements in its working capacity (to be paid out of previous earnings, like the preferred dividends of the last five years.) Of the increased production resulting from this increased capacity, it may, if fortunate, realize 5 per cent as its share, with 95 per cent going to the public.

The corporation had $12,000,000 of net earnings in 1931, deficits in 1932, 1933, 1934 and the above-named net in 1935, making a five year record with a net aggregate deficit of $115,159,758. These are current operating losses, not including a "write-down" of $270,000,000 in the property account, as the result of a review of valuations. The last report says of this "write-down":

> **Broadly, these adjustments are attributable to the developments in the art and mechanics of steel-making which have operated to reduce the normally expected life of such facilities, and to changes in plant location based upon shifting markets and transportation facilities.**

Notwithstanding this five year record, the expenditures for improvements must go on, for this is the only way to a resumption of dividends. Cost and prices must be reduced.

Differing Views of Equality

People view all things from different angles and in different lights and have different ideas about "equality." To some it seems strange that "equality" should be mentioned in connection with income taxes. There were 48,830,000 persons "gainfully employed" in this country in 1930, according to the census, but only 2,037,645 or approximately 1 to 24, paid any Federal income tax. The number paying any surtax is not stated, but in that year the surtaxes began above $10,000, and the revenue report shows that only 259,454 persons paid taxes on incomes above that class; or, in comparison with the "gainfully employed," about 1 to 188. At the higher levels the numbers fall rapidly, with only 60,000 paying on incomes above $25,000. This concentration of taxation is based in part upon the principle of "ability to pay," which has an accepted justification; but the extreme concentration is avowedly prompted by the purpose to force an arbitrary distribution of wealth. This purpose is doubtless inspired by the assumption that the large incomes are devoted exclusively to the service of the owners, which is far from the truth, as witness the 5 to 95 ratio shown by the record quoted above.

Excepting the normal tax on corporation dividends, the new taxes now pending are planned to fall entirely upon the industries and super-tax-payers, apparently in the expectation that they will fall upon no others. But notwithstanding the limited number of persons who will pay them, there is reason to apprehend a far wider distribution of the effects than the planners are expecting. There is reason to believe that these taxes will fall most heavily

upon the very type of industrial leadership that has been most influential in the development of industry, the enlargement of employment, the rise of wages, and in making the difference that exists between the standard of living in this country and that of China and India.

The serial article upon "Wealth and Its Distribution" is omitted this month because this article is devoted to that subject.

Expanding Gold Production

The available figures for the first two months of this year indicate that the world output of gold will probably make another record in 1936. The Union of South Africa, Canada and the United States, which are the first, third and fourth largest producers of gold, each mined practically 100,000 ounces more gold than during the same period last year. Soviet Russia, now the world's second largest producer of the yellow metal, recently announced a plan to step up her output to over 10 million ounces in 1936, or almost double the 1935 production. Even if only a small part of the Russian expansion program is realized, the world output of gold will easily reach another record level, possibly 33-35 million ounces of gold, and even higher figures are expected by some. This would be the fifth consecutive year since 1931 in which the output of gold has exceeded the old previous record made in 1915.

Production of gold declined materially after the close of the war and the low point was reached in 1922 when only 15.4 million ounces were extracted. This decline obviously was due to the rise of mining costs while the coinage value remained the same. From then on production rose slowly, remaining at a level of 16-20 million ounces for most of the post-war decade. This reflected chiefly the expanding output of the Rand fields in South Africa, which were being exploited more effectively. The output of other countries dropped off, however, particularly that of Australia and the United States.

The combined stimulation of the decline in commodity prices after 1930, and the increasing premium on gold in terms of devalued currencies, reversed the trend of gold output. Gold production was encouraged in all lands where a trace of gold could be found and by 1932 all previous records, even that of 1915, had been shattered by a wide margin.

Attracted by the possibilities of large profits, new capital flowed into gold mining and hundreds of new gold mines were opened and older ones extended. Old mining camps, dead since the days of the western gold rush, once more bustled with action and gold-prospecting was stimulated even in the Southeast, Georgia and Alabama, where practically no gold had been mined in about one hundred years. In Canada, gold prospecting extended mining operations into the regions close to the polar circle, near Slave and Bear Lakes. Airplane service and modern extractive methods did much to make the opening of these gold fields economically practicable.

In Australia, New Zealand and Chile the reopening of the old gold fields came at an opportune time and aided not only in absorbing unemployed, but also in providing badly needed foreign exchange.

In Russia, in the last few years almost 700,000 people have found employment in gold mining, which was given a new lease on life by the introduction of dredges. The dredges increased tremendously the output of the Siberian placer areas, where until then gold had been extracted only by the panning method. Mechanization has also stimulated the output of the Ural gold fields. Russia has exported most of her gold, using it as a means of payment for machinery and the goods which she is still unable to produce. By obtaining much needed foreign exchange through the export of gold, large quantities of foodstuffs which had previously been shipped out of the country were released for home consumption. Gold mining, therefore, has been one of the factors which contributed to the rise in the standard of living of the Russian population.

The Situation in South Africa

In South Africa the devaluation of the African pound in December 1932 almost overnight increased the price of gold by 50 per cent. A graduated tax was imposed on the profits of the gold mining companies, with the intention of having the State benefit from the gold premium. The tax favored the working of lower grade deposits and new areas, thereby providing more employment; it kept the gold output down although the quantity of milled ore increased considerably. Hence the output last year was somewhat below the record of 11 million ounces established in 1932. New mines, which are now coming into production as a result of extensive prospecting in 1933 and 1934, should help from now on to increase the output. The Union Corporation, one of the principal South African finance houses, anticipates an output of 15 million ounces in the future; at any rate the life of the South African gold fields has been greatly extended.

The higher gold prices have increased the national income; where South Africa had been getting 85 shillings an ounce, she now receives over 140 shillings an ounce. Industries and agriculture were also helped, not only through the devaluation of the pound which afforded them greater protection and enabled them to compete abroad, but by the increased payrolls of miners. Government finances improved to such an extent that the last three years have shown substantial surpluses in the budgets, despite tax reductions, ambitious road building and social programs. The country is experiencing a real boom, the extent of which

may be observed from the imports, which rose from 32 million pounds in 1932 to almost 75 million pounds in 1935. Yet in spite of these large payments abroad gold continues to accumulate in the Reserve Bank of the Union.

Dehoarding and Hoarding

The expansion of gold production from some 20 million ounces in 1929 to over 30 million ounces in 1935 and possibly to 33-35 million ounces in 1936 is only a part of the story. The devaluation of world currencies such as the pound and the dollar has in itself given an added monetary value to the annual addition to the world gold stocks. Thus, the value of gold production increased from $317,000,000 in 1922 and $405,000,000 in 1929 to $1,067,000,000 in 1935, and possibly $1,200,000,000 in 1936. Of course they are not the same "dollars" in gold content, but have the same legal significance, and increased uncertainty attaches to their purchasing power.

Still another significant change has taken place. Before the depression, India and other Eastern countries which have been traditionally gold-hoarding countries absorbed, together with industries and arts, practically two-thirds of the annual output of gold, leaving only one-third available for monetary reserves. This situation has changed radically. India and China have become sellers of gold, thereby augmenting rather than reducing the stocks elsewhere available for monetary use. India alone has shipped in the last four and a half years almost £180,000,000 ($900,000,000) of gold. Together with the shipments from China and British Malaya, the gold released from the Far Eastern hoards must have reached over one billion dollars. The industrial use of gold has likewise declined considerably, gold being replaced by platinum which is now actually cheaper.

On the other hand, a substantial part of the new supply of gold is being absorbed in private hoards in western countries. Allowing for consumption in the arts and for the changes in the monetary stocks of 50 central banks, which increased in 1935 by some $700,000,000, according to the figures published in the Federal Reserve Bulletin, there is a balance unaccounted for which approximates $500,000,000. This must have been added to existing hoards, which probably run into several billions of dollars.

Influence on Prices

Evidently the gold situation has undergone a complete change. In terms of the new United States dollar, the world's production has doubled since 1933, which would be sensational news if the world did not have so much to distract its attention. Certainly the most ardent advocate of cheap money need no longer agitate for paper, or for further devaluation of existing metallic units, on the ground of gold scarcity. It is possible that the leading topic on the agenda of the next international monetary conference will be "How to Control the Gold Output." The vast sums of gold that have been withheld or withdrawn from banking reserves for hoarding, together with the disruption of trade relations and general lack of confidence, account for the fact that thus far prices have been influenced but slightly. The index of the British Board of Trade shows a price rise of only about 5 per cent since 1931, and this is partly accounted for by the rise of agricultural staples, which have been affected by smaller crops. This slight response to the increasing supply of gold is proof conclusive that increased supplies of money must be accompanied by the *will to use it*, in order to have any effect on prices. Despite this slight response to date, it cannot be doubted that "in the long run" these increasing gold supplies will make themselves felt upon prices, unless the governments of the world take action to nullify the influence.

The Value of Gold Production
(In Millions of Old Dollars)
One Ounce = $20.67

Year	South Africa	Russia	Canada	U.S.A.	Australia	All Others	Total
1890	10	23	1	33	30	22	119
1900	6	20	28	79	73	48	254
1910	155	35	10	96	65	93	454
1915	186	27	19	99	48	89	468
1922	144	2	27	48	18	78	317
1929	215	21	40	46	12	71	405
1930	221	29	43	43	10	84	430
1931	223	35	54	45	13	93	463
1932	238	39	63	45	14	103	502
1933	227	54	61	45	16	120	523
(In Millions of New Dollars) One Ounce = $35.00							
1934	364	147	102	94	31	228	966
1935	375	196	111	109	31	245	1,067

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